EXECUTIVE SECRETARIAT

Routing Slip

TO:		ACTION	INFO	DATE	INITIAL
1	DCI				
2	DDCI				
3	EXDIR				
4	D/ICS				
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8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/EEO				
14	D/Pers				
15	D/OEA				
16	C/PAD/OEA				
17	A/IA	✓			
18	AO/DCI				
19	C/IPD/OIS				
20	NIO/Econ		✓		
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	SUSPENSE				
	Date				

Remarks:

17 to 20: FYI

Doug

DCI EXEC REG

Executive Secretary

7/12/83

Date

3637 (10-81)

THE WHITE HOUSE
WASHINGTON

83-3485

CABINET AFFAIRS STAFFING MEMORANDUM

DATE: 7/11/83 NUMBER: 118821CA DUE BY: _____

SUBJECT: Cabinet Council on Commerce and Trade, Tuesday, July 12, 1983 - 3:00 pm - Cabinet Room

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☑	☐
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☐	☑
Transportation	☑	☐
Energy	☑	☐
Education	☐	☑
Counsellor	☑	☐
OMB	☐	☑
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
CEA	☑	☐
CEQ	☐	☐
OSTP	☑	☐
_____	☐	☐
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	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☐	☑
Darman *(For WH Staffing)*	☐	☑
Harper	☑	☐
Jenkins	☐	☑
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CCCT/Gunn	☑	☐
CCEA/Porter	☐	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: Attached are papers on the "Antitrust and Intellectual Property Improvement to Enhance International Trade Opportunities" to be discussed tomorrow immediately following the CCCT Meeting with the President.

RETURN TO:

☐ **Craig L. Fuller**
Assistant to the President for Cabinet Affairs
456-2823

☑ **Becky Norton Dunlop**
Director, Office of Cabinet Affairs
456-2800

THE WHITE HOUSE

WASHINGTON

July 11, 1983

MEMORANDUM FOR MEMBERS OF THE CABINET COUNCIL ON COMMERCE AND TRADE

FROM: WENDELL W. GUNN
Executive Secretary

SUBJECT: Papers for the July 12 Meeting

Attached are two documents for the July 12 meeting of the Cabinet Council on Commerce and Trade. The first, a memorandum from the Attorney General, is an explanation of the Joint R&D draft legislation which Secretary Baldrige described in his testimony on June 29 to the Senate Judiciary Committee. The second is a study paper, prepared by Commerce, for discussion at the meeting, entitled "Increasing the Efficiency of U.S. Industries to Enhance Their Competitiveness in World Markets."

Attachments

Office of the Attorney General
Washington, D. C. 20530

July 11, 1983

MEMORANDUM TO: The Cabinet Council on Commerce and Trade

FROM: William French Smith
Attorney General

SUBJECT: Antitrust and Intellectual Property Improvements to Enhance International Trade Opportunities

I. Discussion

The recent emergence of strong foreign competitors makes it imperative that United States regulatory policies do not unnecessarily limit the flexibility of American business to respond to challenges and opportunities both here and abroad. The Department of Justice examined the antitrust and intellectual property laws from this perspective, and last March proposed a four-part legislative package to improve the international competitiveness of American industry, to maintain United States leadership in research, innovation, and high technology, and to respond to economic policies of other nations without compromising our strong commitment to free international trade. The President approved this package at a March 24, 1983 Cabinet meeting, and it was circulated informally to the Congress.

Discussions between the Administration and Congress revealed that congressional support for the package would be strengthened by the addition of a fifth provision, dealing specifically with the antitrust status of joint research and development (R&D) ventures. The Commerce and Justice Departments jointly agreed on the appropriate formulation of such a provision. They testified in favor of it on June 29 before the Senate Judiciary Committee's Subcommittee on Patents, Copyrights and Trademarks, and on June 30 before the House Science and Technology Committee's Subcommittees on Investigations and Oversight and Science, Research, and Technology. In the course of their testimony, Justice and Commerce Department spokesmen also officially unveiled the four legislative provisions that have been formally endorsed by the Administration.

II. Legislative Proposals

The Administration's original four-part legislative reform program together with the more recent Commerce-Justice Department joint R&D proposal have been reformulated as a five-part legislative package entitled the National Innovation and Productivity Act of 1983 ("1983 Act"). The joint R&D proposal is embodied in Title II of the 1983 Act, and the four previously approved proposals comprise Titles III-VI of the 1983 Act (Title I of the 1983 Act sets forth its name). These Titles provide as follows:

1. Title II amends sections 4 and 16 of the Clayton Act to provide that no joint R&D ventures may be treated as per se illegal, and to immunize joint R&D ventures that have been fully disclosed to the Justice Department and the Federal Trade Commission from private antitrust suits and from government antitrust suits for damages.

There is a misperception that the antitrust laws discourage joint R&D effort, regardless of its benefits. Although the courts and the Justice Department now are sensitive to these concerns, American industry has indicated that because of uncertainty as to future legal interpretations, the antitrust laws serve as a serious obstacle to procompetitive R&D ventures. The risk of costly antitrust damage suits may sufficiently reduce the expected returns from innovative joint R&D to discourage certain socially desirable ventures from being formed. Adoption of the proposed statutory amendments would completely eliminate the antitrust disincentive for joint venturers who disclose their activities to the government, and shield other joint venturers from the inappropriate application of the harsh per se rule, which condemns specified conduct out of hand without regard to its competitive effect. At the same time, these amendments would provide a safeguard against socially undesirable behavior by preserving the government's right to seek injunctions against anticompetitive joint ventures.

2. Title III amends section 4 of the Clayton Act to provide for actual damages, rather than punitive treble damages, with regard to potentially procompetitive activity analyzed under the rule of reason, such as intellectual property licensing.

Mandatory trebling of antitrust damages (the long standing rule) may usefully deter per se antitrust violations -- categories of conduct deemed so likely to injure competition that they merit being deemed illegal without inquiry into competitive effect in every case (for example, price-fixing among direct competitors).

However, the threat of mandatory trebling for non-per se violations discourages conduct that would improve productivity and benefit consumers, such as intellectual property licensing, because of uncertainties in antitrust law. Business planners cannot rely with certainty on government enforcement policies to avoid the threat of treble damages, since public enforcement authorities have no control over ill-advised private antitrust litigation. Moreover, because of the evolving and often uncertain character of antitrust law it is fundamentally unfair to impose mandatory treble damages in all cases. This undesirable result could be precluded by the proposed statutory change.

3. Title IV amends the Clayton Act to require the courts to scrutinize intellectual property licensing agreements under the rule of reason in antitrust cases.

The ability to license intellectual property encourages innovation, by permitting the intellectual property holder to match his own knowledge and other advantages with those of his licensees, and by allowing the intellectual property holder to utilize his property in the way he deems most effective. Despite these efficiencies, courts have sometimes condemned licensing practices under the antitrust laws without consideration of their basic procompetitive nature and purpose. Our legislative proposals would rectify this situation, by requiring the courts to weigh the pro-competitive purposes of such agreements rather than applying rules of per se illegality.

4. Title V amends the patent and copyright laws to require the courts to find actual harm to competition before denying enforcement of exclusive rights granted under the patent and copyright laws.

In circumstances where a patentee's or copyright holder's behavior is said to be a "misuse" of the patent or copyright, courts have refused to enforce the inventor's exclusive rights, thus allowing free use of the invention and destroying the value of the intellectual property. The misuse doctrine, which is based on the erroneous premise that certain practices invariably are anticompetitive, can seriously retard innovation and efficiency. Accordingly, existing patent and copyright law should be amended to assure that the competitive effects of potentially beneficial practices are judged on a case-by-case basis.

5. Title VI amends the patent law to give process patent holders the same ability to protect their domestic markets from off-shore infringement as the owners of product patents.

Under current law, a firm cannot avoid infringement of a product patent by manufacturing the product overseas and then importing it into the United States, because the use or sale of the product in the United States would infringe the patent. In contrast, there is no law that the holder of a process patent can use to stop a firm from practicing the process patent overseas, and then selling the product made by that process in the United States. This inequitable disparity of treatment discourages innovation in the process patent area. It follows that patent law should be amended to accord the same protection to process patent holders as is currently enjoyed by product patent holders.

III. Recommendation

The Administration has already endorsed for submission to Congress four of the five substantive provisions in the 1983 Act. The Administration should now endorse the fifth provision, dealing with joint R&D ventures, in order to ensure prompt congressional consideration of this important legislative package.

Increasing the Efficiency of U.S. Industries to Enhance Their Competitiveness in World Markets

Background

At our meeting of December 17, 1982, we addressed the need to clarify and modify the antitrust laws to promote the competitiveness of U.S. goods and services in world markets. At that time, the decision was made that:

> An Interagency Task Force, chaired by the Department of Justice, (would) identify antitrust barriers to the competitiveness of U.S. businesses in world markets and recommend policy changes as appropriate. Areas of examination...include joint research and development by private concerns, application of U.S. antitrust law to subsidiaries of U.S. firms operating in foreign countries, and the definition of an international competitive market.

In the last several weeks, the efforts of that Task Force have resulted in a major advance in the area of the antitrust policy on joint research and development ventures.

In testimony before the Senate Judiciary Committee on June 29, Secretary Baldrige and Assistant Attorney General Baxter announced our agreement on the antitrust reform package currently under review within the Administration. A major provision of this package would exempt joint R&D from all private antitrust actions and all government actions for damages under the antitrust laws based on conduct that is part of a research and development program that has been disclosed to the government. The government could, however, seek an injunction to halt any actions by the joint venture thought to be harmful to competition. In addition to the new R&D Section, the proposal under review contains four additional reforms in the antitrust laws which are of equal importance. These additional reforms are: a section which would eliminate treble damages for non per se antitrust violations; a section assuring that Intellectual Property licensing under the antitrust laws is a non per se offense; a section dealing with patent and copyright misuse; and a section dealing with process patents.

The reform package will have an important effect upon the competitiveness of U.S. firms in domestic and world markets. Congressional support is strong, as evidenced by Senator Dole's introduction of S. 1561, entitled the "National Joint Research and Development Policy Act of 1983." Dole's legislation would implement the joint R&D provisions of the reform package with the sole difference that it would provide for private suits for

actual damages only. Thus prospects seem bright for the enactment of the joint research and development provisions of the reform package.

The United States in a World Market

At the same time that we recognize the success of our efforts in the area of joint research and development, we should not lose sight of other antitrust policies that affect the competitiveness of U.S. firms. In particular, I am concerned that U.S. firms may not have enough flexibility under the U.S. antitrust laws to conduct mergers that allow them to respond to increased foreign competition and the changing structure of the world economy.

The prosperity of the American people, and of American business, today depends more than ever before upon the ability of U.S. firms to compete successfully in world markets. Particularly during the past decade our prosperity has become significantly dependent on the global economy. Following World War II, the productive capacity of the United States relative to the rest of the industrial world gave this country the ability to compete successfully in almost every market and in almost any product area.

Over time, however, the industrial economies of Europe and Japan have rebuilt, recovered, and significantly increased their market share relative to the United States in virtually every product category and geographic market. The U.S. economy has grown at a lower rate than most large industrial nations. This is due in part to the relatively slower growth in U.S. productivity. In addition, the developing countries have built up their industrial sectors to the point where they now challenge us in a number of product areas.

The international situation provides a serious challenge to our own economic objectives. The United States is facing and will continue to face intense competition for markets. The health of our economy and our ability to create new jobs for an expanding work force depends in large part on our ability as a nation to compete successfully in world markets.

In sum, the U.S. economy is no longer an island unto itself. Today our imports annually total about $250 billion. In 1970, our total trade--imports plus exports--equaled about 8 percent of the gross national product. By 1980, our total trade equaled about 18 percent of our GNP. In addition, between 1960 and 1980 our share of world exports of manufactured goods declined from 25 percent to only 18 percent.

How Mergers Improve Economic Efficiency and U.S. Firms' Competitiveness in World Markets

Efficiencies frequently occur as production increases, but the source of the improvement is often unclear. The causes of efficiencies brought about by merger may include the following:

- allowing the after-merger firm to operate plants more fully by combining production into a few plants while closing others;
- increasing the production runs of items whose average production costs fall as the cumulative total number of units produced in all periods increases;
- allowing the after-merger firm to operate more effectively by closing older plants and directing production to newer, more technically advanced plants;
- increasing the availability and reducing the cost of capital for the after-merger firms;
- centralizing firms' internal capital used to conduct research and development for new products, or used for productivity improvements in the manufacturing process;
- centralizing the skilled labor, or "human capital", required to manage the firm, or to conduct specialized research, or to achieve quality production; and finally,
- increasing the availability of efficiencies in transportation and marketing.

It would be consistent with the policy of this Administration to provide an economic climate that favors productivity improvement by authorizing mergers that increase efficiency. As we all know, industries facing decline in this country rarely die a quiet death. For some industries at least, mergers might be the means of avoiding demands in later years for government bailouts for failing firms, or for protectionism in the form of high tariffs. At the same time, however, we must remain vigilant to prevent mergers that create monopolies to the detriment of the U.S. consumer.

Monopoly Profits or Economies of Scale

The main reason for preventing efficiency-increasing mergers is that they increase concentration, thereby raising the probability of explicit or implicit collusion. The main reasons for allowing such mergers are that the increase in concentration can only be postponed not prevented, that the earlier society can enjoy the benefits of increased efficiency the better off it is, that delay may enable foreign firms to outcompete U.S. firms in world markets, and that in those few cases in which collusion would occur the antitrust laws can be used against the collusive practices.

Preventing efficiency-enhancing mergers may decrease concentration and the probability of collusion but may involve a cost to society. A correlation between profit rates and concentration ratios has been found by many economists. The issue, though, is whether the increased profits occur because of collusion or because of increased efficiency.

If firms in an industry collude, and there are no significant scale economies, then one would expect all firms in the industry to make about the same level of higher-than-average profits. Recent studies suggest, however, that efficiencies are present, since large firms in specific industries tend to make higher profits than smaller firms in the same industries.

Do U.S. Antitrust Laws Prevent Mergers?

The Sherman Act prevents mergers that result in an actual and adverse impact on the vitality of competition. The Clayton Act and the FTC Act were designed to reach threats to the vitality of competition in their incipiency. In bringing charges under these Acts the Government typically does not need to show an actual and adverse impact on the vitality of competition. Specific cases deal with trends and with changes in measures of concentration as indicators of the probability that a merger will have anticompetitive effects. There is no requirement that the probability of the anticompetitive effects of a merger should be higher when there are efficiencies available to the after merger firm and higher still when the merging firms are in competition with foreign firms that can exploit these efficiencies.

The objectives of the U.S. antitrust laws are as valid today as they were on the day they were enacted. However, the statutory framework enacted to meet those objectives has in some applications become obsolete, and now may have an anticompetitive effect in operation. Instead of fostering efficient, competitive industries in the United States the antitrust laws may weaken U.S. industries under attack from foreign competitors. The situation is made more serious since the firms of our major trading partners are free under their laws to conduct mergers barred to U.S. firms.

In the United States, the use of domestic market share or concentration ratios as the primary yardstick to measure the competitive impact of mergers and acquisitions has the effect of preventing such activities, even when mergers might enhance the competitiveness of U.S. firms over foreign firms in U.S. and other world markets. The Federal Trade Commission has included the presence of efficiencies in the charges it has brought seeking to prevent mergers. The Supreme Court has held that the presence of efficiencies can be a legitimate reason to prevent a merger.

Enforcement policies pertaining to Section 7 of the Clayton Act are described in the Merger Guidelines published by the Department of Justice. A decision on the legality of a merger normally depends upon the concentration of the market where the merger will take place, as measured by the market shares enjoyed by each firm in that market. The Guidelines, of course, are a statement of the Department of Justice's enforcement policies and do not bind the courts or preclude private suits. The Merger Guidelines employ the Herfindahl-Hirschman Index (the "HHI") to assess an industry's concentration by making calculations on the market shares of the various firms in the market. If a proposed merger makes the HHI rise significantly, then it will likely be challenged. These HHI scores are translated into enforcement policies in the Merger Guidelines.

The practical effect of Section 7 of the Clayton Act, and of the Merger Guidelines, can be better understood by looking at a specific industry. The steel industry has become a focus for many of the concerns raised here. An example of this is the recent statement of Mr. David M. Roderick, Chairman of the American Iron and Steel Institute, which was reported in the Washington Post, May 26, 1983. Mr. Roderick stated that, in order to create a more competitive steel industry capable of competing abroad, the antitrust laws governing mergers should be more liberally interpreted or, if that is not possible, be changed. In his view, had more liberal antitrust laws been in effect in 1974 the Nation might have been able to save some 200 domestic steel facilities that have now been closed permanently.

Over 80 percent of all steel production in the U.S. is accounted for by the top 10 firms. Mergers among the atomistic remainder of the steel industry would likely not be challenged; however, this offers no help to the top ten firms in the steel industry, which represent the bulk of the nation's steel capacity.

The Interaction of Economic Analysis and Legal Analysis

Some U.S. industries are in secular decline. The problems of these industries are unusually severe because the economy as a whole has until recently been in cyclical decline, because the competition from foreign firms for U.S. markets has intensified, and because of structural changes occurring in the U.S. economy. Within this environment, demands for protection against foreign firms have increased.

U.S. high technology industries are experiencing increased foreign competition, in some cases because the U.S. technological advantage has been reduced or eliminated and in other cases because of targeting or other circumstances. Other

countries form consortia of their domestic firms to compete against U.S. industries; in some cases the consortia involve firms from more than one country. In the U.S., antitrust authorities can prevent mergers on the basis of narrowly defined product lines, even though it may be too early to know what product lines might evolve in the affected industries, or on the basis of narrowly defined markets, even though it may be too early to know what markets might eventually be served by the industries.

This Administration is deeply committed to allowing free markets to function. But these markets operate within a legal framework, and the merger law component of this framework is preventing some industries from operating as efficiently as possible. This should be changed.

Declining industries that face foreign competition should be allowed to phase out their obsolete facilities and maintain their efficient facilities. High technology and new technology industries that face foreign competition should be allowed to participate in mergers that accelerate the emergence of their products and markets.

Allowing mergers that increase efficiency, will not solve all of the problems of declining industries. But, the Act will allow these industries to scale themselves down more efficiently. The Act will not solve all of the problems of high technology and new technology industries. But, it will allow them to merge more securely and more efficiently. In a case of actual and adverse monopolistic behavior, all firms will, and should, continue to be subject to all of the provisions of the Sherman Act.

The problems created by present US antitrust policy are, in part, real and, in part, a product of the perceptions of the business community. These perceptions, however, govern business behavior. They may best be dispelled by new legislation that comes out foursquare for increased efficiency.

Conclusion

There are two reasons why efficiency-enhancing mergers should be allowed even if the efficiency gains might eventually be realized by internal expansion. First, the earlier the efficiency gains are realized, the greater the benefit to society; delaying efficiency gains by insisting that they occur by internal expansions wastes resources. Second, if foreign firms are allowed to merge to increase efficiency and U.S. firms are prevented from doing so, then the relatively small firms that are driven out of business are most likely to be U.S.-based. In this case measures of concentration may fall

initially as foreign firms enter the U.S. market. As smaller U.S. firms are driven out of business, however, measures of concentration rise. By preventing U.S. firms from merging, the increase in concentration is postponed and a share of the U.S. market is awarded to foreign firms.

The Cabinet Council on Commerce and Trade in conjunction with the Cabinet Council on Legal Policy should consider possible modifications to our antitrust laws to permit mergers which increase the efficiency and competitiveness of U.S. firms in world markets. The objective of such modifications would be to assure U.S. firms the same flexibility to conduct mergers which is now enjoyed by firms in Japan, West Germany and other countries. At the same time, any changes in the antitrust laws should protect the interests of U.S. consumers by assuring that mergers not result in the monopolization of any market.